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## TAXATION VERSUS BOND ISSUES FOR FINANCING THE WAR<sup>1</sup>

The controversy which has been raging between the advocates of taxation and the advocates of bond issues, as a means of war financing, results in part from lack of clear thinking and in part from the conflicting interests of individuals and classes. Confusion of thought is probably the principal source of conflict. There is no economic subject as to which fallacies are more widespread and deep-seated.

We shall clarify our thought if with some precision we consider, first, the sources from which funds for war expenditures can be drawn. It should be observed that this inquiry comes substantially to the same thing as an inquiry regarding the sources from which the labor and the commodities for war uses can be obtained. What the government needs for war is not money, but men and goods.

The only important source of funds for war expenditure consists of the surplus of current income—the excess of the income of the people above their other expenditures during the actual war period. This, again, is the same thing as saying that it is chiefly by the diversion of the current productive power of the nation to war channels that the war must be provided with men and supplies. The surplus of income represents the surplus of labor performed and commodities produced during the war which are not used for non-war purposes.

A surplus of current income available for war expenditure may be obtained in three ways: first, by an increase of production through speeding up; secondly, by saving in consumption; and thirdly, by reducing the investment of new capital in non-war enterprises.

<sup>1</sup> Presented before the conference of the Western Economic Society and the City Club of Chicago, June 21, 1917.

There seem to be those who suppose that the entire burden of the war can be carried by speeding up production and increasing its efficiency. The slogan of "business as usual" implies this idea. We have been told that there is no particular need of economy in consumption except of food; and, also, that the nation ought not to slacken its investment of capital during the war, but ought, if anything, to increase such investment in order that it may be better able to compete in the markets of the world when the war is over. Most of those who have taken these positions are simply resting on fallacy. They think that one can eat his cake and have it too. Some of them, however, honestly believe that the productive power of the country is normally far below its possible maximum and that it is capable of vast expansion under stimulus.

It is true that a considerable expenditure of an unusual character may be taken care of by speeding up production. In ordinary times a great deal of labor and capital are wholly or partly idle or are working with comparative inefficiency. The new demand for production created by the war tends to keep all labor and capital busy and puts pressure on them to increase their efficiency. But we must remember that industry in the United States has already been speeded up materially in the last three years because of the demand for war supplies to be shipped abroad. While additional increase in production may be achieved in the same direction, the limits are probably not wide.

There can be no doubt that, if our own war expenditures—aside from what we supply to the Allies—become, as they easily may, equal to a quarter or more of the present national income, increased efficiency of production will fall far short of meeting them. It will be absolutely essential for us both to save in consumption and to reduce materially the annual investment in new capital.

It is evident that even the poorer classes of the community can, if put to the necessity, save considerably in current consumption, while the more well-to-do could reduce their consumption by a very large fraction. That the people must save, if they are to pay war taxes or to buy war bonds in large amounts, really scarcely needs argument. The fallacy of "business as usual" during war is

kin to the old fallacy that extravagant expenditure creates demand for labor and is good for the people. Saving in war time is a patriotic duty.

It has been estimated by the National City Bank that approximately \$5,000,000,000 of the annual income of the country is in normal times devoted to new investments. It is a familiar fact that many persons of large income invest annually from half to nine-tenths of their income. Much as we should prefer not to check our industrial progress, we must remember that the very fate of all our past investments—indeed, the fate of the nation itself—is at stake in the war, and that, purely from the material standpoint, it is good economy to spend what is necessary to save them, even if we temporarily forego industrial expansion. It is probable, in fact, that the largest one source of funds for the conduct of the war will have to be found in the diversion of that surplus income which ordinarily goes into investment.

Sources of war revenue other than the surplus of current national income are, for the most part, either not available for the United States or comparatively unimportant.

In the first place, it is evident that a war might be financed in part by the accumulation by the government of great quantities of munitions and other supplies during previous times of peace. That means preparedness. That our government has done very little in this direction is all too obvious.

In the second place, a war may be financed to some extent by borrowing abroad, by securing the surplus of the income of foreign countries on promise of repayment out of future income of the home country. It is obvious that the United States could not now, if it would, use this means of war finance; on the contrary, it is under the necessity of itself lending heavily to its allies.

In the third place, some writers lay considerable stress on the thought that previous accumulations of private capital may furnish an important means of war finance. Professor Seligman, for example, in his recent brochure, *How to Finance the War*, suggests that there may be a large loan fund in existence, the accumulated profits of recent years which have not yet been invested, the use of which in payment of subscriptions to the loan involves simply

a change of investment from private enterprise to government service.

This suggestion rests in considerable part on a confusion between individual economy and the economy of society as a whole. There is not at any one time a very large uninvested surplus of previous income. The individual may have a large amount, say, of last year's income deposited in a bank or invested in a temporary loan. He expects to withdraw the deposit or to collect the loan later and to make a more permanent investment. For him it is an available surplus. Meantime, however, the money is being used. It is represented by fixed or circulating capital in the hands of borrowers from the bank or from the individual capitalist. If the owner of the surplus income withdraws it from the bank or from the loan to buy government bonds or otherwise finance the war, the borrowers must, primarily from the surplus of their current income, repay what they have borrowed. Current income must, for the most part, foot the bill.

Again, Professor Henry C. Adams suggests that, while we cannot convert fixed capital into war supplies, it is possible to do so with circulating capital. Such a process, however, has very narrow limits. Circulating capital, in the last analysis, consists essentially of partly finished products, of stocks of finished consumable goods, and of finished capital goods of certain kinds not yet actually in productive use. The total of such products and goods in the country at any one time probably represents only a fraction of one year's income. Many of them are not adapted to war uses. Besides, only a comparatively small part of them can be dispensed with. They are, in the main, a part of the necessary means of conducting business. At the utmost, it would scarcely be possible to finance more than part of the first year of a war through the use of previously accumulated circulating capital.

Another way, comparatively unimportant, in which previously accumulated capital may be made a source of war revenue is by allowing fixed capital to depreciate during the war. However, so far as such fixed capital is used in necessary production, a policy of this kind would soon prove disastrous. It would before long result in a reduction of current income.

The conclusion seems to be, therefore, that *the surplus of current income must be the principal source of funds for the financing of the present war*. The fundamental question is whether that surplus shall be obtained for government use by borrowing it or by taxation.

The most basic fact which must be borne in mind in discussing this problem is that, *for the people considered as a whole, domestic borrowing postpones no burden to the future*. This really follows at once from the fact that only goods produced before or during the war or men living during the war can be used in conducting the conflict. We cannot shoot a shell to be made in 1930. The future is not here to bear burdens. Of course borrowing abroad does make it possible to postpone the burden of the home country.

Borrowing at home, so far as a nation as a whole is concerned, is precisely similar to borrowing by an individual from himself. The reason the individual may gain by borrowing is because he borrows from another person. Would John Smith gain anything by writing a note to this effect: "Fifty years from date I and my heirs promise to pay to myself and my heirs \$1,000 with interest at 6 per cent"? So far as the nation as a nation is concerned, a government bond issued at home is precisely similar to such a note in its effect.

*This idea that the burden of war expenditures can be deferred to future generations is the supreme fallacy of finance*. Many a business man, whom we have every reason to consider sincere, insists that he is willing to bear his full and just share of the war burdens, but adds that he can see no fairness in making the present generation bear the entire cost of the war, when the future generations are equally to profit by it. The future generations will, to be sure, have their burden from this war. They will have, in all probability, a somewhat depleted heritage of capital. They will presumably have to pay billions in pensions. But the future generations cannot repay to the present generation its outlay in the conduct of the war.

Conceive, for example, that the present generation should wholly pass away in forty years. If war bonds still remained unpaid, the next generation would have to bear taxes to pay interest and principal. But it would be paying to itself; it would have inherited

the bonds as well as the taxes. What it paid would not be a burden on the people of that generation as such. It would not be repaying the present generation. The fact that generations gradually merge into one another does not change in the slightest the logic of the matter.

The same argument which applies to the future generations applies as well to the future years of the present generation. Professor Seligman, among others, is not disposed to favor long-term bonds, but urges short-time bonds in preference to taxes for a large part of the war expenditure. He says it would be easier for the people to pay for the war in ten years than in three, assuming that it is over in three years. As a matter of fact, for the people considered as a whole it would not be one whit easier. What the people as a whole receive as interest and principal repayment, that they must also pay. They defer no burden by the short-time bonds.

While domestic bond issues postpone no burdens to the future as such, *they do make possible a readjustment of the war outlay as between individuals and classes in the community.* The really fundamental questions involved in the issue of taxation versus borrowing as a means of war finance are questions of social justice in the distribution of burdens. The war must be paid for now, but there may be a reassessment of expenses among us afterward. For instance, those who have paid more in the first place may be recouped by those who have paid less. We shall all have bought our chips, but we may still play to see who gets, and who loses, them.

If we could assure ourselves that the distribution of taxes after the war would be as just as the distribution of taxes during the war, there would be little choice between taxation and borrowing, were it not for the fact that, by inflating prices, bond issues cause injustice as between individuals and classes, a point which will be discussed later.

Most of what will be said with regard to the relative advantages of bonds and of taxation has particular reference to that part of war expenditures which is paid for, in the first instance, out of the surplus of the current income of the people. To the extent

that previously accumulated capital can be and is to be taken for financing the war, it should be obtained by borrowing and not by taxation. It may be suggested, however, that if the advantages of taxation over borrowing as a means of securing the surplus of current income should appear material, we ought seriously to question the wisdom of trying to induce men to contribute out of their capital by offering bonds, many of which of course will be bought at the same time by others out of income. At any rate, the policy of issuing bonds for this purpose may well be confined to the early stages of the war, during which, in any case, it is difficult to get the taxing machinery into shape to collect adequate funds.

In one very minor respect, perhaps, the reassessment of war expenses after the war, made possible by the bond plan, may contribute to justice. There are at all times occurring changes in the incomes of individuals. Great fortunes disappear. The newly rich man of the future will of course be a beneficiary of the results of the war. It might be considered fair perhaps that out of his new riches he should contribute large taxes toward the bonds held by those who furnished funds during the war. However, these changes in the distribution of income are not so great as is sometimes supposed. Particularly if the war is financed by short-time bonds, the great bulk of the nation's income will, during the period of bond repayment, be distributed in substantially the same fashion as at present. The really important question regarding the just assessment of war burdens does not arise out of changes in the distribution of income, but out of the inequality in the distribution of income. The important thing is that there should be a fair apportionment of taxation as between the richer and the poorer classes. It is much to be feared that it would be less possible to secure such a fair apportionment if the war expenditures are reassessed after the war under the bond plan than if they are settled, once for all, under the policy of "pay as you go."

In order to get any clear idea as to the justice and the feasibility of different methods of distributing the burden of war expenditure, it is necessary to arrive at some estimate, in the first place, of the proportion of the total national income which will be required for war purposes, and, in the second place, of the distribution of



the national income among families, classified according to the amount of their incomes.

It is not improbable that the United States will, by next year or at any rate before the war is over, be spending at least one-third of the total annual income of its people for the conduct of the war. In all probability in Germany today half of the nation's income is going into the war; half of the productive power of the country is being devoted to the conflict. It is commonly stated that the United States must expect to spend 15 or 20 billion dollars per annum on the war. This is roughly two-fifths of the national income. No one knows, of course, exactly what that income is. The most thorough investigation of the subject is that of W. I. King. His estimate for 1910, which I have checked with some care, was in round numbers \$30,000,000,000. In view of the increase of population, the speeding up of industry, and the inflation of the currency, it is probable that the present figure would be around \$40,000,000,000; it might possibly be \$45,000,000,000. Needless to say, the real income has not increased in such a ratio, but we are dealing with income expressed in terms of money.

The accompanying table (Table I) attempts a rough classification of this national income. I have undertaken to divide it into ten equal parts, according to the magnitude of individual family incomes, and to show the approximate limits of the family incomes constituting each class. In this table I have followed in a general way the classification made by W. I. King, but, on account of the rise in prices and wages, I have raised considerably the limits of the several income classes.

Whatever the imperfections of this table, it is accurate enough to demonstrate that a very large proportion of the total income of the country is made up of the millions of small incomes. It is probable that incomes exceeding \$25,000 do not in the aggregate form more than one-tenth of the national income.

If we assume that as much as one-fourth of the total income of the country will be required for war purposes, two conclusions follow at once from such a classification of incomes. In the first place, it is not possible to finance the war exclusively through the contributions of the richer classes; and, in the second place, it is

almost equally impossible to finance it by calling for an equal rate of contribution from each class. These conclusions hold whether the money be obtained by taxes or by bonds.

TABLE I

Approximate distribution of national income into tenths according to magnitude of individual family incomes [Col. 1]; approximate percentage of its income which each class should contribute in order that the total contribution should equal one-fourth of national income [Col. 2]; and percentage of total contribution which each class would then contribute [Col. 3].

No.	Incomes Falling within Class (Col. 1)	Percentage of Income Contributable (Col. 2)	Percentage of Total Contribution Furnished by Each Class (Col. 3)
1.....	\$ 0-\$ 600	10	4.0
2.....	600- 750	10½	4.2
3.....	750- 900	11½	4.6
4.....	900- 1,050	13	5.2
5.....	1,050- 1,250	15	6.0
6.....	1,250- 1,500	18	7.2
7.....	1,500- 2,000	22	8.8
8.....	2,000- 5,000	30	12.0
9.....	5,000- 25,000	45	18.0
10.....	25,000 and over	75	30.0
Average and total		25	100.0

Even if substantially all the income of persons having incomes of \$5,000 or more were turned over to the government, it would not be enough to meet the war expenditures. On the other hand, it cannot be expected that families with incomes of less than \$900, whose incomes together make up roughly three-tenths of the national total, should out of their meager means contribute one-fourth to the government. Undoubtedly such families could continue to exist, even with such a deep cut into their incomes, but it would be most unwise from the standpoint of national efficiency, and indeed suicidal from the political standpoint, to adopt any financial policy which would compel them to do so, unless, to be sure, our straits become so desperate that, by common consent, it appears necessary to spend considerably more than one-fourth of the total national income for war purposes.

I have thought it worth while to compute a series of progressively increasing percentages, representing in some fashion what

proportion of its income each of the classes distinguished in the table might be expected, without undue hardship, to contribute in the first instance, by loans or taxes or both, to the support of the war. No assumption is here made that these percentages represent a just distribution of the final burden of the war. On the basis of a total war expenditure amounting to one-fourth of the

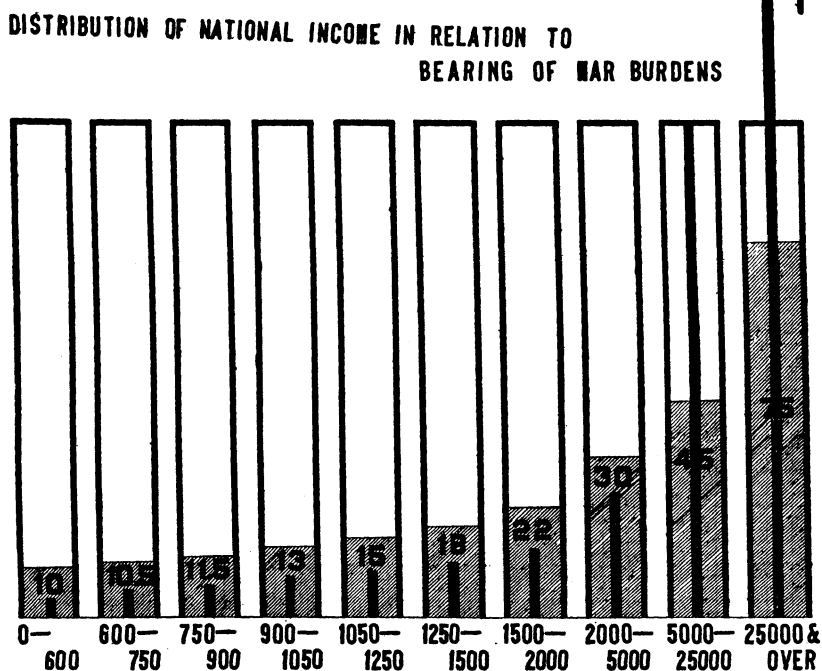


FIG. 1

national income, I have figured, for example, that the class with the smallest incomes might be expected to contribute 10 per cent of their incomes, and the class with the largest incomes, 75 per cent of theirs. The average of the several percentages is 25 per cent. The percentages increase but slowly for the lower-income classes, but much more rapidly for the higher classes. A column is also added showing what proportion of the total war expenditure would, on the basis of these percentages, be contributed by

each class, ranging from a contribution of 4 per cent by the lowest class to one of 30 per cent by the highest class.

It may, of course, be argued by the advocates of highly progressive taxation for war purposes that the rates of taxation might be made even more sharply progressive than the percentages in this table; that the rates for the lowest classes might be made still lower, and those for the highest classes still higher. Or it may be urged by the friends of the bond-issue plan that the rich can be induced to lend to the government a larger proportion of their income than 75 per cent. One may doubt, however, whether it is feasible to obtain, either by taxation or by borrowing, much higher percentages than here indicated, so long as no more than one-fourth of the total national income is required for war purposes. It should be borne in mind that these percentages are calculated on the basis of the average income of the class, not of the highest income. Doubtless the higher classes should be subdivided with a graduation of the percentages as incomes increase. We cannot expect, at least not for some time to come, that the more well-to-do will completely change their habits of consumption, or that they will entirely forego making investments in non-war enterprises. To attempt to obtain for government use more than half of an income of, say, \$12,000 (which is about the average for the income class from \$5,000 to \$25,000) would scarcely seem practicable, at least for some time to come.

At any rate, let us assume for the sake of clearness in the further discussion that the various income classes do contribute during the war itself, either by paying taxes or by buying bonds, in the proportion indicated.

Now, it is perfectly evident that, if the war should be financed wholly by domestic bonds, purchased out of surplus income by the various classes in the proportions indicated, and if after the war the taxes for the debt service should be laid upon the several classes in precisely the same proportion, the bond issue would not result in any general shifting of burdens. Each class would then be paying the interest and repaying the principal of the bonds it held. Apart from the effect of the bonds in inflating prices they would result in no advantage and no disadvantage to any

class, as compared with the plan of collecting the same sums in the first instance by taxation. Were it clearly understood that (so far as income classes rather than individuals are concerned) post-war taxes would be levied in practically the same proportion as bonds are held, there would be little ground for desire on the part of the wealthy that the war be financed by bond issues rather than by taxation.

However, it is possible by the bond plan to readjust the burden after the war—possible to put more of it on the poorer classes. For while, for example, it might not be politically feasible to obtain from those in the class with the lowest incomes more than, say, 10 per cent of their incomes during the war, which would represent 4 per cent of the total war expenditure, that class would undoubtedly be able, by dividing the burden over a considerable series of years, to pay interest and principal on more than 4 per cent of the national debt. The members of this class would after the war pay as taxes more than they received on the bonds they held. In this way the rates of taxation for the more well-to-do could be kept down. They would receive more than they paid. In other words, part of what they had advanced to the government would be repaid to them by other social classes.

This brings us, then, to the two fundamental questions in the issue of taxation versus borrowing: In the first place, is the ultimate assessment of the burden of war expense on a highly progressive principle socially just? In the second place, is it feasible to collect by taxation any such proportions of the income of the several classes as it would be necessary to collect if no bonds were issued?

We certainly could not collect the entire cost of the war by taxation unless we levied taxes at highly progressive rates; at rates approximately corresponding to the percentages set forth in Table I. Is this a fair distribution? Or would it be more fair that part of the moneys which the more well-to-do contributed should be later repaid to them by the less wealthy?

Most of us, business men and economists alike, believe in some measure of progression in the taxes for war purposes, whether levied during the war or after its close. The only difference among

us is usually a matter of degree. If, as is pretty generally conceded, the principal measure of just distribution in taxation is the ability to pay, the degree of sacrifice involved in the payment, the rich man unquestionably may properly be called on to pay a materially larger proportion of his income as a tax than the poor man. To take from a man who has an income of \$600 a tax of \$60 cuts distinctly into his standard of living; it makes him forego what are virtual, if not absolute, necessities. To take from a man who has an income of \$100,000 a tax of \$10,000 involves little, if any, reduction in his standard of living; in all probability it means merely a reduction in the investments which he makes out of income—a slowing up in the rate of accumulation of his wealth and of increase in his income. The sacrifice of the poorer man is far greater than that of the richer.

The principle of equality of sacrifice justifies a very considerable measure of progression in tax rates, even for ordinary peace expenditures. For war expenditures the argument in favor of progression is still stronger, and a more rapid rate of progression is justifiable. For in war time the need of the nation is so great that it calls upon multitudes of its citizens for the greatest of all sacrifices, that of their very lives. The welfare of the entire country, both for the present and for the future, is at stake. It is the duty of every citizen to share in war's burdens to his utmost. There is no definable limit to his obligation. The citizen who contributes even his entire income beyond what is necessary to subsistence itself, does less than the citizen who contributes himself to the nation.

If conscription of men is justifiable, conscription of income is a logical corollary. This slogan has been attacked in some quarters on the ground that it assumes that only the poorer men will be conscripted to fight. It is urged, and rightly enough, that, as a matter of fact, the rich are equally subject to conscription, and, indeed, are quite as likely as the poor to cheerfully devote their lives to the nation's service. But has this criticism any real validity? The principle of conscription implies the justice of demanding from each citizen all that he can give, both of personal service and of money contribution, not the one as a substi-

tute for the other. It is the duty of the poor man, if called upon, to give what he can spare from his income, and his life as well, and it is the duty of the rich man to do the same. We ask of each citizen to sacrifice his all, if need be, for his fellow-men and his posterity.

In discussing the social justice of a system of war financing, we may properly consider, moreover, the ultimate effect upon the distribution of wealth and income among classes of the community. Many, if not most, of us believe that, quite regardless of the methods by which the more well-to-do have obtained their wealth or obtain their present incomes, the inequality in income as among the various classes is greater than is socially desirable. A tremendous gap lies between the penury of the millions and the affluence of the few. We should dislike to see any action of the government in connection with the war which would increase this disparity of income.

Now, it is evident that if the war is financed by bonds with a view afterward to providing for the debt service by taxes less highly progressive than would be necessary if the expenses were met by taxation during the war itself, *the result would be ultimately to make the rich richer*. Part, at least, of the saving which they undertook during the war in order to contribute to the government's needs would ultimately be repaid to them out of taxes levied upon the poorer classes. Their capital would thus become greater than it was before the war. After the taxes for repaying war bonds had ceased, the annual income of the rich bond-buyer would be actually greater than before the war. On the other hand, if during the war itself highly progressive taxes were levied sufficient to meet the war expenditures, they would not serve, in any appreciable degree at least, permanently to lessen the inequality of income. They would not make the rich permanently poorer. This statement assumes that the taxes would be paid out of income, not out of capital—an assumption which requires but insignificant qualification. The sacrifice of all classes would be temporary—for the period of the war only. After the war expenditure ceased each class would be in the same relative position as before. Only during the war would the income of the rich be reduced more than that of the poor.

In substance, then, war financing by bond issues is likely, even apart from its effect on incomes through the inflation of prices, to result in an increased inequality in the distribution of wealth and income. This is not a necessary result, for the taxes for debt service might be so levied as to prevent it, as virtually to make each class pay interest on, and repay the principal of, its own loans to the government. There would be little likelihood, however, that the taxes after the war would be made sufficiently progressive to bring this about. The great political power of the well-to-do classes would almost certainly enable them, if they sought to do so, to shift part of the burden on the poorer classes, and they would probably seek to do so. The patriotism which during the war itself might induce the rich willingly to pay taxes according to the full measure of their ability is bound to wane considerably when the war is over. There is little enthusiasm about paying for a dead horse.

*The tax policy, then, is more likely than the bond policy to mean the ultimate payment of war burdens in the manner which is socially equitable.*

Thus far we have passed over the matter of the effect of bond issues on the incomes of different individuals and classes by reason of the inflation of prices. There has been so much discussion already regarding the effects of national borrowing upon prices that I shall not enter into a detailed presentation of the argument. It seems to be the opinion of the large majority of economists and of others capable of judging the question, that, except so far as the bonds are sold to individuals who severally pay for them out of the immediate surplus of their incomes, they are likely to serve to inflate prices. That is to say, so far as bonds are purchased with borrowed money, they bring about an increase in the amount of credit in the community which has an effect similar to an increase in the money supply itself. The transaction would not represent simply the transfer of purchasing power from individuals to the government. It would represent an increase of purchasing power. It is also generally agreed that it would be almost impossible to prevent large resort to borrowing on the part of subscribers to war bonds.



There is a grave danger, moreover, that continued and heavy resort to borrowing as a means of war finance will ultimately lead to the direct inflation of the currency by paper money. The temptation to enforce the making of loans to the government by paying for the government's purchases with paper money becomes very great as soon as the borrowing has reached such a stage that interest rates are high. Moreover, under our present banking laws it will be possible for the banks to increase the currency through the issue of bank notes, if the demands of expanding credits make it profitable to do so.

One need not undertake to prove that expansion of the circulating medium, either in the form of actual currency or bank credits and the use of checks, inflates prices. We all know it must do so. All that is necessary is to emphasize the social injustice which results from price inflation. Were all prices advanced alike, including the price of all forms of labor and including interest on previous investments, price inflation would not change the relative incomes of different individuals and classes, and would do little harm. Such, however, is far from being the case. Wages always lag far behind commodity prices. Salaries generally lag behind wages. Many incomes fixed by long contracts do not increase at all; the holder of a railroad bond, for example, gets no addition to his income when prices advance. Those whose incomes increase not at all or increase less suffer for the benefit of those whose products advance more rapidly in price. The wage-earner, for example, finds, not merely an absolute, but a relative, increase in the cost of his living. The prices of what he buys rise more than his wages. Grave injustice as between individuals and classes is thus worked by the inflation of prices, and any policy which is certain or even likely to inflate prices should be avoided unless there are still graver evils attendant on every alternative policy.

The enormous advance in prices which has already taken place since the war in Europe began renders it particularly important that we should, if possible, avoid further inflation. While many individuals and some large classes of the population have profited through the high prices of recent years and the general stimulation of business, it is more than probable that the wage-earning classes

in general are worse off today than they were before the war, and it is certain that great numbers of other persons are worse off than before. Indeed, one of the serious objections to levying any considerable war taxes upon the wage-earning and salaried classes lies precisely in the diminution of real income which so many of them have already suffered.

The question still remains, however, whether it is feasible from the fiscal and political standpoints to collect by taxation during the war period a sufficient amount to cover the war expenditures, whether there are practical difficulties in the tax plan which offset its advantages in principle. To pay as we go would, as already shown, demand both extremely high taxes on the rich and taxes of considerable severity upon the poorer classes. Can we devise means of assessing and collecting taxes which will bring the revenue needed, which will not destroy business, and which will preserve a fair measure of justice as between individuals?

We are, of course, confronted with difficulties of psychology and of mistaken economic ideas. The fallacy so widely prevalent that the future can and should share in the burden of war expenditure might, if the pay-as-we-go policy were adopted, cause bitterness and lead to deliberate attempts at evasion, even on the part of those who are perfectly willing to bear their fair share of the burden. When even a man of intelligence harbors the idea that by buying a bond he is making an investment instead of a contribution, without ever asking himself whether his future taxes for debt service will exceed what he receives in the form of interest and principal, it may seem preferable to take advantage of this notion as a means of securing money for the government more easily. It would appear, however, that the majority of the people already dimly recognize the fallacy; a great many of them recognize it clearly. The poorer classes, from whom, after all, we must expect considerable contributions to the war expense, very generally are coming to feel that the bond plan is likely to be a means of increasing their relative share of the burden. Moreover, we must consider the effect of the two methods of finance, not only upon the attitude of the people toward giving financial support to the war, but also upon their attitude toward enlistment and other personal service. A majority

of the men who fight will probably soon come to understand the financial problem and to feel that those who stay at home are supporting them more loyally by paying taxes than by buying bonds.

If once this fallacious idea as to the postponement of burdens can be dispelled, it is probable that there would be comparatively little difficulty in securing general support for heavy taxation, even from those charged with the highest rates, and that the great majority of the people would pay such taxes without attempt at evasion. One can hardly overestimate the effect of patriotic sentiment during war time as an aid to the fiscal policy of the government. Much heavier taxes can be successfully collected during war than during peace. It is by no means improbable, for example, that after a year or two of war a given rate of income tax would produce twice the revenue it produced before the war. Of course there would be evasions, and evasions represent, not merely loss of revenue, but injustice as between individuals. Nevertheless, the evasions even of heavy war-time taxes are likely to be less than the aggregate of evasions during a longer period of post-war taxes designed to provide for debt service, when patriotic spirit no longer is so efficacious in checking evasion.

One of the chief arguments ordinarily advanced against extremely heavy taxation is that it would destroy business, that it would, to use an old adage widely quoted in this connection, kill the goose that lays the golden egg. For the most part this criticism rests on fallacious reasoning. It is true that taxes unintelligently devised may have such an effect in considerable measure. The only fund out of which taxes ought to be paid is the fund of net income. So far as they are drawn from net income, they have comparatively little tendency to destroy business. They cut into the profits of business, but they do not eliminate the source of profits. It may readily be that by adopting indirect methods of attempting to reach net income the government may cut off the net income of certain enterprises altogether or may in some cases take more than the net income. It follows merely that the greatest care should be exercised in choosing the method of taxation.

The notion that even taxes paid out of net income tend to destroy business is substantially unsound, although it possesses

some small elements of truth. The underlying fallacy is closely kin to the fallacy of "business as usual." Those who argue that heavy taxes, even if paid out of net income, will destroy business have usually in mind the fact that they would check consumption, especially of unnecessary commodities, and would thus reduce the demand for certain goods, reduce the profits of those producing them, and lessen their ability to contribute to the support of the war. Such persons overlook the fact that the productive power which is deprived of a market in certain directions will, for the most part, be greedily absorbed in the production of things necessary for the war; that the total income of the community is not necessarily reduced by reducing consumption in certain directions. It is true that some capital, which is engaged in the production of luxuries and which is incapable of adaptation to the production of required commodities, must go out of commission, thus tending to lessen the national income, but this loss is probably more than counterbalanced by the continuous and efficient employment of other capital and of practically all labor—by the general speeding up of industry.

Those who object to heavy taxation on this ground, moreover, fail to realize that very much the same effect must necessarily follow from large borrowing on the part of the government. Money used to buy government bonds can, no more than money used to pay taxes, be devoted to the ordinary channels of consumption. It is a fair question, indeed, whether the financing of the war primarily by bond issues would not disturb business even more than would financing primarily by taxation. Large government borrowing necessarily diverts much capital from its ordinary employment. For one thing, it is bound to result in extensive calling of private loans for the purpose of investment in government bonds. This may go so far as seriously to hamper many enterprises, even enterprises engaged in very necessary lines of production; it may even bring about a financial crisis.

It must be conceded, however, that exceedingly high taxes may in some cases cause hardship and disturb business, and that under certain conditions loans might cause less hardship and disturbance. Not all income of men of a given income class is equally available

for immediate contribution to the government. The net income of the one may be pledged to the payment of indebtedness, of rent, of subscriptions to securities made before the tax was levied. The income of another may be really needed for new investment in an enterprise necessary for the proper production of the country, perhaps for war production itself. The income of still a third may be almost in its entirety readily available for contribution to the government; indeed, he may have accumulations of past income, which, from his own personal standpoint at any rate, are readily convertible. To tax all three heavily is in some measure to disturb business and to inflict unequal burdens. If, on the other hand, the man with free income or with accumulations of the past can buy bonds, the interest and principal of which will in part be repaid to him subsequently by the others, an advantageous adjustment will have been made. Putting the matter in another way, the bond plan leaves a considerable measure of leeway; it leaves to the individual a desirable amount of choice, of discretion, as to the time and manner of his contribution to the Treasury.

Were it not for the serious danger that bond issues would be made to result, not merely in such reasonable adjustments of burdens in point of time, but in a wholesale transfer of them from the more well-to-do to the poorer classes, the argument above mentioned would go far to justify a considerable resort to the policy of borrowing. As it is, the balance of advantage still seems to remain with the tax policy. It would seem possible for arrangements to be made by most men who are subjected to heavy taxation, by which they may tide themselves over any temporary difficulty due to the tying up of income. And, in particular, the objection that heavy taxation would render difficult the investment of the new capital needed for war enterprises themselves may surely be met by advances of capital by the government, or by permitting certain corporations, under due regulation, to retain free from tax, at least for the time being, the surplus profits which they need for further investment.

It is no part of the purpose of this paper to suggest in detail a system of war taxation. To discuss the many problems involved would take a great amount of time. A few fundamental ideas may, however, be presented.

In the first place, it is evident that, if the principle of progression, which is so essential both to justice and to the obtaining of the necessary revenue, is to be largely applied, very great reliance must be placed upon the taxation of individual incomes. While the excess-profits tax, in the sense of a tax which seeks to take for the government part of the increased profits due to the war itself, is just and may properly be a large source of revenue, the heavy taxation of corporations merely as such is incompatible with the principle of progression. Taxes upon corporations fall equally upon persons of very widely varying individual incomes. One stockholder may be a multi-millionaire, another a widow in moderate circumstances, and another even a wage-earner or a farmer of very small total income. Since practically everyone fully supports the idea of taxing at least the medium-sized and large incomes directly and progressively, all that is necessary to do with the income tax, in case the policy of financing the war largely by taxation is adopted, is to make up our minds to decidedly higher rates all along the line than have thus far been proposed. The machinery for ascertaining the incomes, at least the moderate and large incomes, is in existence or in process of organization. A heavy and highly progressive personal income tax would of course result in some evasion, which would both reduce the revenue and work individual injustice, but the evasion would be, as already suggested, far less than in times of peace. Not only would the patriotic sentiment help greatly, but the public would be prepared to support severe penalties for evasion, which in times of peace are scarcely enforceable.

It should of course be understood that, whatever our views as to the ultimate weight of taxation which is just and proper, we ought not to attempt to apply that full weight at the beginning of the war. It takes time to work out satisfactory laws and to develop adequate administrative machinery. Even more important, it takes time for the patriotic spirit of sacrifice to reach its maximum, and time for the people to realize the necessity of drastic taxation, and to accustom themselves to it. We may properly tax much more heavily the second year of the war than the first, and still more heavily later on. Much of what is said here as to proper

methods and rates of taxation, both of taxes on incomes and of other taxes, has reference rather to the later years than to the first year of war.

It is probable that, if the policy were to collect practically the entire expense of the war by direct income taxes, the relative rates on incomes of different magnitudes indicated by the table already presented would represent not far from a fair distribution. In other words, if it were deemed necessary to take a quarter of the total national income for government use, the rates of tax might properly begin with about ten per cent on the smallest incomes, rise slowly to about 20 per cent on incomes of, say, \$2,000, and then rise more rapidly until the average income of the highest income group distinguished in Table I would be taxed about 75 per cent.

Of course the progression should be made more gradual and continued to a higher maximum by subdividing the higher incomes into groups with varying rates. The very largest incomes of all might properly, it seems, be taxed up to almost 90 per cent of their amount. It is no more severe a burden to take 90 per cent of an income of \$10,000,000 a year, which would leave the recipient still the huge sum of \$1,000,000 to spend or to invest, than to take 10 per cent of an income of \$500 or \$600.

It does not seem wise to adopt a scheme of taxation which takes all of the excess of income above any limit whatever. There is some argument, perhaps, from the standpoint of social justice, in favor of the often advocated proposition that no man during the war should be allowed to retain more than, say, \$100,000; that all that he receives above such an amount should go to the state. The difficulty is that fixing an absolute limit of this sort would, at least in the case of many individuals, discourage enterprise. They would feel that it was not worth while to exert themselves to the utmost, and especially not worth while to take risks, merely for the sake of increasing what they could pay to the government. On the other hand, there would still remain a very considerable incentive to enterprise if the income-producer were allowed to retain for himself a fraction, even as small a fraction as 10 per cent, of the additional income he could produce above a given limit.

It is a well-recognized fact that it is both unjust and inexpedient from a fiscal standpoint to increase the rate of taxation on the total income in passing from a given income class to the next higher. Such a policy might easily result in leaving a person with a larger income a smaller amount, after paying his higher rate of tax, than was left to a person of smaller income after paying the lower tax. It is desirable, of course, that the higher rate should be applied in each case to the excess of income above the limits of the class. Table II, which has been worked out on this principle of applying increasing rates to the successive increments, would result substantially in taking from the average income of each of the ten income classes distinguished in Table I the percentage indicated in that table. For example, if the rate on incomes up to \$600 were fixed at 10 per cent, a rate of 15 per cent on the excess over \$600 would result in a total tax, on an income of \$675, equal to 10.6 per cent. This table suggests that the excess of any income over \$100,000 be taxed at 90 per cent. In the case of an income of \$500,000, for example, this would result in a total tax of \$425,000 in round numbers, or 85 per cent of the income. It is not meant to imply, by this discussion of the proper relative rates on different incomes in case the income tax were the sole reliance, that, as a matter of fact, it should be the sole reliance. To the extent that other taxes are used, income-tax rates should be correspondingly adjusted.

The excess-profits tax, as above defined—the war-profits tax—may properly be made to produce a very considerable revenue. There is pretty general agreement as to the justice of the principle that no one should profit by the nation's calamity, that, except so far as it may be necessary to leave some stimulus to enterprise, the profits due to the war itself may justly be taken by the public. There are, however, some difficulties involved.

In the first place, it is impossible to ascertain, and still more impossible to collect, any large fraction of the excess profits of the many concerns and individuals whose special war profits are small in absolute amount. In my opinion, the farmers taken as a whole have probably profited more and will profit more by the war than any other one class; perhaps more than all other classes put together.



There is no satisfactory way, however, to determine or to tax their excess war profits.

TABLE II

Rates of tax on the excess of incomes above specified limits which would result in a distribution of a total tax equal to 25 per cent of the national income approximately in accordance with the percentages of Table I.

INCOME CLASS—BASED ON DIVISION OF TOTAL NATIONAL INCOME INTO 10 EQUAL PARTS	ASSUMED AVERAGE INCOME OF THE CLASS	RATE ON EXCESS OF INCOME ABOVE MINIMUM INCOME OF CLASS	TOTAL TAX ON AVERAGE INCOME OF CLASS	
			Amount (1)	Percentage of Income
\$0-\$600.....	\$ 500	10	\$ 60.00	10.0
600-750.....	675	15	71.25	10.6
750-900.....	825	20	97.50	11.8
900-1,050.....	975	25	131.25	13.5
1,050-1,250.....	1,150	30	180.00	15.7
1,250-1,500.....	1,350	35	245.00	18.1
1,500-2,000.....	1,700	40	377.50	22.2
2,000-5,000.....	3,150	45	1,015.00	32.2
5,000-25,000.....	12,000	50	5,347.50	44.6
25,000 and over.....				
<i>a</i> ) 25,000-100,000.....	45,000	70	25,847.50	57.4
<i>b</i> ) 100,000 and over....	400,000	90	424,347.50	84.9
Simple average of ( <i>a</i> ) and ( <i>b</i> ).....				71.2

The method of arriving at this total may be illustrated thus, for an income of \$975, the assumed average of the fourth class:

On first \$600, 10 per cent equals	\$60.00
On next \$150, 15 per cent equals	22.50
On next \$150, 20 per cent equals	30.00
On excess over \$900 (\$75) 25 per cent equals	18.75
Total	\$131.25

In the second place, it should be borne in mind that, if by excess war profits we mean the additional profits following our own entrance into the war, these will not necessarily be very large. The great demand resulting from the war in Europe had already caused large increases in the profits of many enterprises. The profits of some of these enterprises will doubtless be still further increased by our entrance upon the war, and those of some other enterprises may also be swelled, but the addition may not in the aggregate equal the increase that had previously taken place. On the other hand, there is some measure of injustice involved in levying heavy taxes on the excess of present profits over those

preceding 1914 or 1915. Many thousands of investors have bought stocks of corporations at high prices based on the large earnings of recent years. Some of these are persons of very moderate means. Their incomes and the market prices of their securities would be greatly reduced if a large fraction of the excess of the profits of these corporations, over what they were making before the European war, should be taken by taxation. Of course, so far as the stockholders of these corporations remain the same as they were before the war, there is little, if any, injustice.

It seems on the whole justifiable and politically expedient to levy two kinds of taxes upon the excess profits—one, a tax on the excess by comparison with the three or five years preceding 1915; the other, a tax at a higher rate on the excess since our own entry into the war.

Very little is to be said in favor of an excess-profits tax which takes the form of a tax on the excess profits above a certain percentage on the investment. Such excess of profits may bear no relation to war profits as such, and it may bear very unequally among different individuals who have purchased stocks in the corporation at different times and at widely varying prices. Moreover, the tax would be much more difficult to assess properly because of the uncertainty as to the true investment to be used as a basis of computation.

Income taxes and excess-profits taxes should be the principal forms of taxation designed to reach the families of middle-sized and large incomes. These should perhaps be supplemented by taxes on luxuries, designed to suppress their use and to compel saving, but there would be much less need of these if the other taxes were high. The inheritance tax should be continued, but not greatly increased.

Greater difficulty confronts us when we reach the problem of securing adequate taxes from those of comparatively small income. It is generally considered impracticable to collect direct income taxes from wage-earners and from farmers. It is argued that it is both difficult to ascertain their incomes correctly and expensive to assess and collect the tax. On the other hand, indirect taxes present many objectionable features.

It seems to me not only practicable but desirable that, after the war has continued a year or so, we should undertake to apply income or quasi-income taxes to families with much lower incomes than those made taxable by the recent tax law. The chief argument for doing so lies in the enormous amount of injustice which is bound to result from indirect taxes sufficiently heavy to obtain the revenue that the receivers of such lower incomes ought to contribute if the war is to be financed chiefly by taxation.

Moderate indirect taxes we can put up with despite the inequalities which result, but extremely heavy indirect taxes are most objectionable. In the first place, while it is the proper object in levying an indirect tax that the precise amount shall be shifted to the consumer, it actually happens sometimes that only a part of it can be so shifted, the remainder falling on the original taxpayer or on some middleman, and sometimes, on the other hand, that the consumer is forced to pay to the producer or the middleman more than the amount of the tax. No one can know just what the incidence of heavy taxes on commodities, for example, will prove to be. Moreover, when after the war the government seeks to reduce or to abolish the indirect taxes, all sorts of difficulties and inequalities are likely to appear. In the second place, no one can correctly foresee to what extent heavy indirect taxes will suppress consumption and defeat their own end by failing to produce the anticipated revenue. And finally, even if all the tax and no more is shifted to the consumer, the resulting burden on different individuals and families is likely to bear very little relation to their incomes or to their taxpaying ability.

It would probably be wise in the later years of the war to tax all family incomes exceeding \$1,000 by income taxes in the ordinary sense of the word; that is, by ascertaining as nearly as possible the actual family income and assessing a certain percentage upon it. This would involve little more difficulty, aside from some increase in the ratio of administration expense to revenue, than the application of income taxes to incomes of \$2,000. It seems well worth while, moreover, to consider seriously the feasibility of something akin to the income tax—what may be called a class tax or a quasi-income tax—as a means of obtaining revenue from wage-earners and

farmers with still smaller incomes. Would it not be practicable with a fair measure of accuracy to assign each individual wage-earner, or perhaps better each wage-earning family, to a given income class and to collect a fixed amount of tax from all in that class? It would seem possible, for example, to ascertain fairly well whether a workingman's income for the preceding year fell between \$500 and \$700, and to tax all incomes within these limits a flat sum, such as \$25, making perhaps some deductions for dependents.

As Professor Seligman has stated in his recent brochure, the incomes of farmers are peculiarly difficult to ascertain, and it is even more difficult to tax farmers adequately by indirect methods because they buy much less in proportion to their true incomes than do most other classes of equal wealth. One should not, however, exaggerate the bearing of this difficulty on our general tax problem by overestimating the magnitude of farm income. According to King's calculations, agricultural incomes represent only 22 per cent of the national total; the figure at the outside can hardly exceed 25 per cent.

It would seem possible to apply a rough form of income taxation even to farmers. They might, like wage-earners, be assigned to income classes. In doing so, we might place reliance partly upon their own statements as to production and expenditure and partly upon a valuation of their land and perhaps of their other farming capital. For example, one could by careful statistical inquiry ascertain with a fair degree of accuracy the average or modal income of a farmer in a given state whose farm was assessed at \$10,000, and such information could be used as a check upon the actual reports of income.

However, it would probably be desirable, if such a system of quasi-income taxes were adopted, to make them relatively light, and to supplement them by indirect taxes. While it is doubtful whether even grave imperfections in the assessment of such direct taxes would result in as great injustice among individuals as would follow equally heavy indirect taxes, nevertheless a moderate resort to indirect taxes has certain advantages. The fact that the consumer who pays the tax—to the extent that he actually does pay it—is often not aware, or only dimly aware, that he is being taxed

at all, has a certain value to the fiscal administrator. The policy of levying taxes in such a way as to "procure the most feathers with the least squawking" is bad ethically, but perhaps we must admit it to be in some measure expedient fiscally.

Of course we could, if necessary, put up with indirect taxation as the principal means of reaching all incomes below those now fixed as the minimum for income taxation under the pending bills. It is not entirely clear, however, that one should favor the plan of financing the war primarily by taxation, if this meant that we should have to rely wholly on indirect taxes as a means of obtaining that large part of the national revenue which people who receive incomes of less than \$2,000 ought to contribute. If we are correct in our calculations as to the distribution of income, such incomes represent over two-thirds of the national total; and if our assumption as to the proportion of income which each class might properly be expected to pay for war expenditure is reasonable, it appears that they ought to pay approximately two-fifths of the total taxes. If taxes of \$10,000,000,000 had to be levied in a year, this would mean \$4,000,000,000. The attempt to collect \$4,000,000,000 from these classes by indirect taxation, which would mean a still larger total of indirect taxes for the population as a whole, would involve inequalities and injustice almost, if not quite, as great as those that could possibly result from relying largely on bond issues as a means of finance. If we could confine the indirect taxes to moderate limits the balance of advantage would appear to rest with the tax plan of financing.

It would be by no means out of the question to collect one or even two billions by indirect taxes. The proper method would be to tax heavily a comparatively few necessary articles of consumption. It would be especially the duty of the framers of the tax laws to select articles for taxation which are largely consumed by the farming class. High taxes on such products as flour, sugar, salt, kerosene oil, gasoline, coffee, and tea would be fairly effective for this purpose and might be made to yield a very large total. We should not balk at rates much higher than those heretofore proposed. High rates on a few well-chosen articles would be easier to collect, and would work less injustice among individuals and

classes, than lower rates on a long list of articles and transactions applied with little knowledge as to their actual incidence.

I shall not attempt to draw a perfectly definite conclusion from this discussion. We have before us a problem of relativity, of balancing advantages and disadvantages. On the whole the balance seems to favor an ultimate resort to taxation for a very large part of the war revenues, the share properly increasing as the war progresses. That we should, even in the later years of the war, wholly dispense with borrowing is perhaps not warranted. But to rely upon borrowing for half or more of the war expenditures would seem both unjust and inexpedient.

Finally, it may be stated that the argument for taxation as a means of war finance can hardly be applied as against loans floated in the United States to obtain money, not for expenditure by this country, but for advances to the Allies. In a sense, of course, the Allies are fighting our battles, and it might be good statesmanship for us to give them money outright, in which case it might be collected by taxation; but to the extent that we choose to make our aid to them in the form of loans, it seems proper that those who actually pay the money which goes to these loans should receive the repayment from the foreign countries. In other words, what the United States does in issuing bonds to obtain funds to furnish the Allies is virtually merely to indorse the bonds of the Allies sold to citizens of the United States.

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